

## Feedback from Engagement Strands and Working Groups on Support Costs

Engagement Strand: Professional and Technical Group A
<b>A. Options Considered by the Engagement Strand</b>
<p><b>Option 1:</b> Remove the term “support costs” as it is unhelpful to give the impression that some costs are non-charitable. If there needs to be a distinction, costs could be called “direct” and “indirect” charitable costs.</p> <p><b>Option 2:</b> Any costs that are unusual and have no benefit to the charity, such as losses due to fraud, could be described as losses rather than non-charitable costs. This could take away the issue of normal overheads being perceived as bad, remove some of the judgement and estimation and could also focus trustees’ attention.</p> <p><b>Option 3:</b> Increase the emphasis on narrative information. The disclosures required by the current SORP concentrate on the methods used to allocate support costs. More emphasis on the narrative detail would be more helpful to users and preparers of accounts. Paragraph 8.6<sup>1</sup> of the SORP could provide more detail in this respect. The detailed disclosures on methods of allocating support costs could be replaced by a general explanation of why such costs were incurred.</p> <p><b>Option 4:</b> The guidance on apportioning support costs in Module 8 could still be provided but it should be clear that this is guidance only rather than mandatory and that charities should use methods of allocating appropriate to their charity. Many charities will already be allocating support costs to provide information to funders and for their own management accounts purposes. It should be possible to use these figures for the accounts.</p>
<b>B. Conclusions</b>
<p><b>Option 1:</b> Remove the term “support costs”. There was not a consensus in favour or against this option.</p> <p><b>Options 2 – 4:</b> There appeared to be support for these options (i.e. to separate out unusual costs that do not benefit the charity, to increase the emphasis on narrative information and to make the provisions of the SORP relating to apportioning costs in Module 8 guidance only rather than mandatory).</p> <p><b>Other conclusions:</b></p> <ul style="list-style-type: none"><li>• It was thought that support costs should not be given a high level of prominence in SORP.</li><li>• Table 4, the analysis of support costs, can be removed from the SORP.</li></ul>

<sup>1</sup> Para 8.6 “The activities reported should also be consistent with the significant activities noted in the trustees’ annual report. The narrative provided by the trustees’ annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them.”

- Tables 3 and 13, analysis of charitable activities, can be expanded to show the different type of costs across the top. Specifically, the support costs column would be removed and replaced by a number of columns of specific material costs e.g. wages and salaries, fundraising costs, IT costs etc.

### **C. Other comments**

The Engagement Strand expressed the following views:

- It considered that the charity sector is alone in disclosing support costs separately and detailing the apportionment methodology.
- Deciding how to allocate support costs is time consuming for Trustees; the benefit of doing this in terms of more accurate, consistent accounting information is questionable.
- Comparability of accounting information is not always possible in such a diverse sector. Allocation of support costs therefore seems to be an unnecessary task.
- By allocating support costs to individual charitable activity, it is possible to determine which charitable activity made a profit or loss. This way of thinking is questionable and not necessarily helpful to a user of the accounts.

## **Engagement Strand: Trustees**

### **A. Options Considered by the Engagement Strand**

**Option 1** – to re-commit to the recommendations made by the Engagement Strand at the end of phase one. Specific recommendations relevant to support costs include:

- the use of Plain English accompanied by an additional ‘think non-financial expert first’ approach
- provision of a comprehensive glossary (reflecting terms and definitions used by the regulators) and full indexation to assist cross-referencing. Having clearer definitions, used consistently within the SORP, would be of benefit to the support costs topic
- make it easier to identify whether a provision of the SORP is a legal or regulatory requirement and which provisions are recommended practice, citing sources where relevant, and
- Reduce the length and complexity of the financial notes by better use of referencing, signposting, cross-referencing and hyperlinking.

**Option 2:** To encourage better use of visual and digital information use to enable the charity to tell its story.

The SORP should encourage preparers to include a range of infographics to better inform readers of a charity’s financial and non-financial performance. Simple graphics breaking down the costs of a charity by activity/service/programme could help to illustrate to readers which services/activities are the most resource heavy. Accompanying infographics could highlight the output and impact of those resources in a given programme. However, any required new content should be accompanied by the removal of other unnecessary or out of date recommendations in order not to add to the work of trustees.

**Option 3:** Remove ‘support costs’ as a heading.

The support costs heading is unhelpful as this is not the terminology used on the face of the SoFA and is only used in the financial notes section.

Any comparison between charities on 'overheads' would be challenging given the diversity of the sector.

- Simplifying comparisons of support costs may contribute to further competition amongst charities to state a low 'overhead' figure, which does not accurately portray the costs to a charity of doing something in accordance with the requirements of running a complex organisation.
- Removal of the heading 'support costs' would remove the ability to compare such costs between charities, but this may be a positive as the sector may be too diverse to be able to deliver comparable support costs of any meaning.

In the interests of simplification, the requirement to produce a table like Table 4 in the SORP could perhaps be removed. Any specific items of expenditure normally included in support costs which it is considered should be disclosed, such as audit fees, CEOs salary or trustees' expenses, are either already disclosable by specific provisions or could be in the future. It is noted that no other type of organisation has to provide the same level of analysis as that presented in table 4.

## **B. Conclusions**

**Option 1:** The SORP would benefit from using clearer and simpler language in a more consistent manner across the accounting framework, supporting documentation and other official communication channels.

**Option 2:** No recommendation offered.

**Option 3:** The Engagement Strand supported the removal of 'support costs' as a heading. With this, additional guidance and advice would be helpful to promote a more consistent disclosure of the real costs of running a charity.

The Engagement Strand recommended that Table 4 should be removed from the SORP.

If support costs are retained within the next version of the SORP, additional guidance to trustees (especially non-financial trustees) on how to approach such cost allocations in a consistent manner would be helpful.

## **C. Other Comments**

- The Engagement Strand noted difficulties linking support costs to the narrative account in the Trustees' Annual Report because it details how the charity has delivered its charitable purposes and public benefit.
- A campaign to better educate and inform readers of the inevitable costs of being a charity (to avoid the perception of support costs as 'bad') might be beneficial.
- For a charity with a large fluctuation in income, the reporting of support costs could appear disproportionately high when income levels drop but salary and other support costs remain the same. This is not helpful.
- There is a tension between what might be good for the sector and what the public might expect to see in annual reports and accounts. The public might want to be able to compare support costs, although this may be addressed through an education piece as referred to above.
- The next version of the SORP should be recalibrated to focus on the impact charity has delivered rather than the financial bottom line.
- Para. 8.7 of the SORP should be reviewed and revised as it is currently quite convoluted and ambiguous in its meaning.

<b>Engagement Strand: Professional and Technical Group B</b>
<b>A. Options Considered by the Engagement Strand</b>
<p><b>Option 1:</b> Have support costs and governance costs as separate line items in the SoFA and not allocated to the cost of raising funds and (other) charitable activities.</p> <p>This approach would address concerns over a lack of objectivity and spurious comparability between charities. This approach would also address Engagement Strand members' concerns that charities are 'hiding' support and governance costs, under the guise of the allocation process. Further, this approach would lead to a reduction in the quantity of notes to the financial statements relating to expenditure, including the need to provide full comparatives, and to a reduction in complexity for accounts preparers as the need for apportionment would be removed.</p> <p><b>Option 2:</b> Support costs (and governance costs) could be allocated to activities, other than overhead (indirect) costs which are to be shown separately on the face of the SoFA by charities using the activity basis of reporting.</p> <p>Under both Options 1 and 2, Support costs (or overhead costs) would need to continue to be allocated across funds to ensure that restricted funds bear their 'fair share' of these costs consistent with the terms of the restrictions placed on the funds.</p> <p><b>Option 3:</b> Remove the 'support costs' classification. To illustrate the need for this removal the 'support costs' classification, one member of the Engagement Strand noted that if a charity has a site used solely for charitable activities, all the costs of that site – electricity, gas telephone etc would be assessed as charitable. However, if the same site was used as head office in addition to providing charitable activities, then support costs and overheads would have to be identified and allocated across fundraising and charitable activities.</p>
<b>B. Conclusions</b>
<p>The Engagement Strand appeared not to arrive at a consensus view. There was support for removal of the 'support costs' classification from some Engagement Strand members. However, there was support from some Engagement Strand members for a change of approach, without the removal. A change of approach by adopting either Option 1 or Option 2 outlined above would simplify the SORP requirements without reducing the value of information on expenditure within the financial statements.</p> <p>If 'support costs' are to be retained within the Charities SORP, the Engagement Strand recommends that the SORP prescribes the types of cost which must be treated as 'support costs' and requires charities applying the activity basis to identify all 'support costs' even where a site delivers a single charitable activity.</p>
<b>C. Other Comments</b>
<p>Consideration needs to be given as how best charities and the charity regulators can communicate with users of financial statements, including funders, that support costs are not intrinsically 'bad' costs and that support services are essential to the delivery of a charity's purposes.</p>

<b>Engagement Strand: Large Charities</b>
<b>A. Options Considered by the Engagement Strand</b>
<p><b>Option 1:</b> Discontinue ‘support costs’ as a separate reporting requirement. Costs that might be viewed as ‘support costs’ are actually key underlying costs of running the charity, yet somehow there is a perception from some users e.g. media, that support costs are ‘bad costs’. Reporting support costs gives a false impression to users that they can compare support costs of charities (e.g. costs of an HR department will vary depending on how many employees a charity has). Further, reporting requirements for support costs are very inconsistently applied by charities. It was noted that transparency can be achieved without separate reporting of support costs.</p> <p>Under the existing SoFA format, the Engagement Strand is of the view that drawing out the composition of the cost of raising funds, coupled with the normal expectation in any set of accounts of reporting exceptional items, would greatly simplify, harmonise and enhance a SORP set of accounts. More guidance on the cost of raising funds and how this is calculated and reported in SOFA would be more useful to users of accounts. Further, consideration could be given to only separating out exceptional items in the accounts e.g. fines, re-structuring or exceptional costs that are not part of the day-to-day charitable activities.</p> <p><b>Option 2:</b> Include a tighter definition of what support costs are in the SORP, with clear examples/requirements to also help with consistency.</p>
<b>B. Conclusions</b>
<p><b>Option 1:</b> The Engagement Strand is strongly of the view that the classification of support costs should be discontinued as a separate reporting requirement, in tandem with clearer definitions on the cost of raising funds and the principle of reporting of exceptional items being important. The Engagement Strand contends that this will both simplify and enhance reporting.</p> <p><b>Option 2:</b> Inclusion of a tighter definition of support costs was not the Engagement Strand’s preference and was suggested as an alternative approach for if their view on discontinuation of ‘support costs’ as a separate reporting requirement was not a common theme from other Engagement Strands or not advanced by SORP committee.</p>
<b>C. Other Comments</b>
<ul style="list-style-type: none"> <li>• Support costs are charitable costs by definition as the business of the organisation is ‘charity’.</li> <li>• Several examples were given of how it can be damaging for support costs to be seen as ‘bad’, including the potential for adversely impacting levels of donations.</li> </ul>

<b>Engagement Strand: Academics and regulators and proxies for the public interest</b>
<b>A. Options Considered by the Engagement Strand</b>
<p><b>Option 1:</b> Make no changes to the SORP.</p> <p>One proxy for the public interest commented that it would be simpler to address the perception that support costs are ‘bad’ through an education piece rather than through changing the SORP. A regulator added that it would be a negative outcome if the review of the SORP gave the public less transparency of support costs rather than more.</p>

## **B. Conclusions**

No conclusions were reached, but several issues were discussed as outlined below.

## **C. Other Comments**

- There is a traditional perception about good and bad costs within charities which needs to be addressed. There is a link to the topic of executive pay – it is not well understood that ‘you get what you pay for’. Members of the Engagement Strand expressed the following views that:
  - charities need to tell the public how much they pay their senior staff. They also need to improve explanations about pay.
  - A regulator therefore suggested standardising and mandating the senior pay disclosures provided for in Module 9 of SORP, and also giving consideration to mandating the best practice in Executive Pay set out in the Report of the Inquiry into Charity Senior Executive Pay led by the NCVO, where this differs from Module 9.
- Charities need help to explain better what costs they have in running their organisation. The accounting framework needs to better enable charities to be transparent about support costs and explain how they contribute to achieving the charity’s purpose
- Support costs regularly seem to be misunderstood so it was questioned whether the issue can be resolved by the SORP. There is currently inconsistency in the categorisation and allocation of costs. If this is the case, then is the answer more guidance or more specific rules or does the issue need to be handled differently?
- A regulator noted that multiple options can be more confusing than helpful. Clear direct guidance is required to avoid inconsistent presentation and reporting.
- There may be need for a key facts summary containing information about costs.
- A member of the Engagement Strand commented that all costs are being spent to advance the charitable cause, so splitting out support costs could be questioned. However, the solution is not obvious as if support costs are scrapped, there may be further issues.
- A member of the Engagement Strand commented that splitting costs over activity helps understanding of how the charity is using its resources and if done well then it is more transparent. If there is no single number for support costs in a set of charity accounts then valuable information on the sector would be lost.
  - This is information the public are interested in. When people donate money, they want to see a high proportion spent [directly] on the end cause.
- Narrative is needed as to the reasons for costs and why the costs are necessary in running the charity.
- Regulators and funders can ask for what information they want so perhaps the more salient point is what the general reader of accounts wants. CCEW research indicates a high level of public interest in how money is spent, particularly that a high proportion is used [directly] for charitable activity.
- A regulator questioned how charities manage their costs. If it is different from the support costs model in the SORP, it is reasonable to question the basis for this being a SORP requirement.
- A member of the Engagement Strand questioned whether the allocation of costs causes a lot of extra work for charities – if so, it is reasonable to question cost allocation, particularly if it is not adding any value.

<b>Engagement Strand: Smaller Charities and Independent Examiners</b>
<b>A. Options Considered by the Engagement Strand</b>
<p><b>Option 1:</b> Support more widespread adoption of natural classifications, therefore removing the need for disclosures regarding support costs for the smaller charities choosing to adopt natural classification.</p> <p><b>Option 2:</b> In the light of comments summarised in section C below, the Engagement Strand considered the merits of removing the requirement to report on support costs. The Engagement Strand acknowledged that the identification and analysis of support costs is valuable, but did question whether the information is used, particularly in a smaller charity context.</p>
<b>B. Conclusions</b>
<p><b>Option 1:</b> The Engagement Strand recommends that more widespread adoption of natural classifications should be supported.</p> <p><b>Option 2:</b> Remove the requirement to report on support costs. The Engagement Strand generally was in favour of this option, at least for smaller charities. The Engagement Strand reiterated that they would favour an extension of the threshold for smaller charities to £1m.</p> <p><b>Other conclusions and recommendations:</b> If the view is that support costs do need to be reported by all charities adopting activity based classification then there does need to be some improvement in the guidance within the SORP. That could mean including the definition of support costs into the main body of the SORP and clarifying how to deal with common things like management salaries and the extent to which premises costs would be categorised as support costs. This could be achieved through worked examples.</p>
<b>C. Other Comments</b>
<ul style="list-style-type: none"> <li>• Without detailed examples being provided in order to demonstrate the principles, there is a risk of inconsistency in approaches to expenditure classification. <ul style="list-style-type: none"> <li>○ This is also a problem for examiners in determining whether a charity's accounts comply with the SORP.</li> </ul> </li> <li>• There is a perception that money spent on anything other than direct delivery is bad and so charities are likely to want to minimise costs which are categorised as support or overheads.</li> <li>• The current language in the SORP does appear to be clear. However, there is scope for differing interpretations as to what should be included in support costs – for example the glossary suggests this would include 'general management' but this is not listed in para 8.7 (Identification of costs). Table 4 (Analysis of support costs) is further limited to quite a narrow list of suggested functions. It is not clear then what the expectations are regarding, say management salaries and premises costs which may be significant.</li> <li>• There is a variety of terminology used around the categorisation of anything other than direct costs across the sector (including support costs, overheads and indirect costs; terms that are sometimes used interchangeably). Definitions and examples are important to enable preparers to understand the requirements and comply consistently in financial reporting. <ul style="list-style-type: none"> <li>○ The SORP could also acknowledge that a variety of terms are used when describing costs but make it clear that support costs in the context of preparing</li> </ul> </li> </ul>



SORP accounts does have a specific meaning – i.e. the principle set out in the glossary.

### Engagement Strand: Major Funders & Donors and Government & Public Bodies

#### A. Conclusions and Recommendations

The Engagement Strand is of the view that it would be good to reinstate the cost of Governance back onto the face of the SoFA. This would help to make the accounts easier to read, therefore increasing transparency.

#### B. Other Comments

- When considering grant applications, the practices of funders vary. Whilst some may take interest in the support costs table per the SORP, others would ask applicants for the data in other prescribed formats.
- Consideration should be given to an educational piece of work by the Charity Commission to ensure the public understands that all charities have administrative costs.

### Working Group A

- Acceptance that charities will need to apportion costs between activities, e.g. to write full-cost bids.
- However, this does not necessarily mean the disclosure of support costs is needed.
  - Broad agreement that the support costs disclosure note can be removed
  - “Support costs” should be seen as part of charitable activities. There should be guidance on allocating costs to charitable activities. E.g. using a weighted average for governance costs seems arbitrary, although there was support for keeping “Governance costs” off the face of the SoFA.
  - Removal of the disclosure will help cut clutter.
- There was some concern that apportioning governance costs could be seen as trying to hide something.
- Noted that there is a desire from charities to avoid showing disproportionately high “overheads” to avoid unflattering ratios been calculated.
  - This should be something that the charitable sector pushes back against by offering explanations for costs incurred. i.e. a need to try and end the view of “good” and “bad” behaviour.
- **Conclusions:**
- Grants should be kept separate.
- Disclosure of costs should be by way of a table that uses natural classifications and does not use the term “support costs”.
  - All costs to be included.
  - Costs can be shown by activity, but using natural classifications e.g. staff costs for an activity would include field staff *and* office staff.
- Separate disclosure of types of cost could be mandated where necessary.

### Working Group B



Unanimous support for the note, and the requirement to analyse and disclose support costs, to be removed.